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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. [redacted] 30

UNITED STATES OF AMERICA, On Relation of CHESTER A. WILLOUGHBY, as Trustee in Bankruptcy of NATIONAL MECHANICAL SERVICE COMPANY, a corporation, et al.,

Petitioners,

vs.

SAM HOWARD and CONTINENTAL CASUALTY COMPANY, a corporation,

Respondents.

On Petition for a Writ of Certiorari to The United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF OF RESPONDENTS IN OPPOSITION.

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Petitioners,

vs.

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Respondents.

On Petition for a Writ of Certiorari to The United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF OF RESPONDENTS IN OPPOSITION.

Opinion Below

The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 243 (R. 393).

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended. 28 U. S. C. A. 347(a). The date of the judgment sought to be reviewed is January 8, 1937 (R. 393). A rehearing was denied on January 29, 1937 (R. 406).

Statutes Involved

Section 47 of the Bankruptcy Act, 11 U. S. C. A. 75(a) (3) (4), and General Order 29, 11 U. S. C. A. 53, provide with respect to the official duties of a trustee or receiver in bankruptcy, insofar as they relate to the safekeeping and handling by the officer of bankrupt estate funds coming into his possession pending disbursement or distribution, as follows: the officer must deposit the funds in one of the depositories designated by the bankruptcy court; he may make disbursements thereof only by check or draft countersigned by a judge or referee of the bankruptcy court; he must keep regular accounts thereof and file the required reports.

Section 61 of the Bankruptcy Act, 11 U. S. C. A. 101 provides that courts of bankruptcy shall designate banking institutions as depositories for the funds of bankrupt estates, shall require and approve bonds to be given by depositories to secure such deposits and may from time to time increase the amount thereof, and may change depositories.

The above provisions are set forth in the Appendix.

Principal Question Presented

Whether an official surety bond given by a trustee or receiver in bankruptcy conditioned upon the performance by the principal of his official duties covers a loss of bankrupt estate funds resulting from a closing of the designated depository in which such funds were deposited by the trustee or receiver, on the theory that although not provided by the Act or general orders, an official duty rests on such officer when making or maintaining the deposits in the depository to determine with due care the stability of the depository.

Statement

Petitioners seek certiorari to review the judgment of the Circuit Court of Appeals for the Seventh Circuit reversing a judgment for the petitioners in the District Court and granting the respondents a new trial (R. 402). The cause involves three suits at law, separately brought and thereafter consolidated, to enforce the alleged liability of the respondent, Howard, as trustee and receiver in bankruptcy, and the respondent, Continental Casualty Company, as surety, on certain official trustee's and receiver's bonds, for an amount of bankrupt estate funds deposited by Howard, as trustee or receiver, in the Phillip State Bank & Trust Company of Chicago, and lost at the time of its closing in 1932. The bonds were given in various bankruptcy estates of which Howard acted as trustee or receiver, and provided in substance that the respondents would pay losses which might arise from (a) a failure of Howard to obey an order of court, (b) a failure of Howard faithfully and truly to account for all moneys, assets and effects of the particular bankruptcy estate, and (c) a failure of Howard faithfully to perform "his official duties as said trustee" or receiver (R. 59-60, 65-66).

The case was tried by petitioners in the District Court, as petitioners say in their brief, p. 21, "on the theory that Howard's duty was that of exercising ordinary care as a trustee or receiver in depositing and maintaining bankruptcy funds" in the Phillip State Bank. Their complaint alleged that Howard "negligently, carelessly and improperly deposited and maintained" in the bank the funds in controversy (R. 8, Par. 11; see also R. 9, Par. 12). Petitioners assumed that a want of ordinary care by a trustee or receiver in bankruptcy in regarding the financial condition of a designated depository in which estate deposits

were made and in judging the possibility of such depository being closed, whether by a bank run or otherwise, would constitute a breach of his official bond. The District Court followed this theory and, as petitioners likewise point out, p. 25, its "instructions to the jury were based on the duty of Howard as trustee or receiver, to use the degree of care which would guide a reasonably prudent man in the conduct of his trustee responsibilities."

The Circuit Court of Appeals in the opinion below narrowed its decision to a determination of whether this theory of the legal responsibility of the respondents on the bonds was in error (R. 394, 396). The Court, therefore, for the purpose only of such determination was willing to assume a failure of Howard to regard the stability and solvency of the Phillip State Bank as a reasonably prudent person might have done under the circumstances (R. 398). [It will be noted that much of petitioners' argument on the facts erroneously takes this assumption as a concession.]

If the theory of liability upon which petitioners proceeded below and which the District Court adopted in its charge, was erroneous, the judgment of the Circuit Court of Appeals reversing the cause was sound. In this view of the case, any inaccuracy or omission of fact in the petition for certiorari is of no great significance except to the extent that it might obscure the principal question of law actually decided below and here presented. However, to correct any misimpression which might arise from petitioners' statement, reference may be made to the facts stated in the opinion below (R. 394-396) and to the following facts:

Condition of the bank

The Phillip State Bank, at the time Howard commenced making deposits there in August, 1930, had been in business on the north side of Chicago for over fifteen years

and was of good reputation (R. 286, 256). The bankruptcy court, in designating it a depository in 1930, placed no restriction whatever upon its receipt of funds, whether upon the amount of estate deposits it could receive or otherwise (R. 143). There is no proof that the depository was in an insolvent or unsound financial condition at any time prior to its closing by the run of June, 1932. The quarter-annual bank reports filed throughout the period with the state auditor showed solvency (R. 83-101, 139, see Opinion, R. 395-396). The figures mentioned by petitioners, pp. 4-5, in respect to the financial position of the depository are incomplete as a comparison with the statistical data set forth in the opinion below (R. 395-396) and the record (R. 83-101) will show. For example, the figure stated by petitioners, p. 5, as the amount of deposits "at the time said bank closed," is the figure *after* the run had occurred and withdrawals were made (R. 72).

The bank runs

The runs at the depository were all of fortuitous, external cause, occurring during the nationwide panic of 1931-1933.* They resulted from no internal condition of the bank. The April, 1931 run was precipitated by the closing of several banks on the north side within a period of five days after the Builders & Merchants Bank & Trust Company failed (R. 137, 169, 259). The June run followed the announcement of the mergers of two of the largest banks of Chicago both located in the "loop" or business area of the city, with two other "loop" banks, in an attempt to save several hundred million dollars of deposits (R. 120, 121, 171, 137, 138). All four of the merging banks were

*Judicial notice may be taken of the character of the times. *Great Northern Railway Co.* v. *Weeks*, 297 U. S. 135, 149.

bankruptcy depositories (R. 112-113). In the runs which resulted from the mergers, nine city banks, including three bankruptcy depositories, closed (R. 137, 138, 171, 112-113). The September run at the Phillip State Bank occurred when the Rogers Park National Bank, located directly across the street from it, failed in the aftermath of the closing of the so-called "Bain chain," a group of twelve banks located in different parts of the city (R. 173, 138, 195, 196).

Period preceding Phillip closing

In the fall of 1931, the Phillip State Bank was designated an "A" institution by the Chicago Clearing House Association in a general survey then made of the banking situation (R. 176). Earlier in summer it took over the Illinois State Bank of Evanston (R. 129-131). During the period from September, 1931 until the close of the depository by the run of June, 1932 there was no material change in the financial condition of the depository except for a heavier withdrawal around Christmas time (R. 177, 196, Opinion, R. 396). In the first four months of 1932, withdrawn deposits of the preceding year which had not already been redeposited (Opinion, R. 395) were returning at the rate of $100,000 per month (R. 72). In March, 1932 the bank reached its highest point of liquidity for the period, with quick assets constituting 37.54% of the amount of total deposits (R. 72).

The Phillip State Bank was closed in June, 1932 in a run which continued for several days (R. 122). The withdrawals came without warning. They were not due to any unsound condition but were caused by a neighborhood panic which followed the closing of the Devon Trust & Savings Bank, a north side bank (R. 122, 138).

Court supervision of the depository

At the time of the city-wide runs which followed the merging of the large Chicago banks in mid-1931, the bankruptcy court in the district not only requested immediate full reports of all trustees of the amount of their bankrupt estate deposits at each of the depositories, including the Phillip State, and entered the order of June 11, directing the regular filing thereafter of quarter-annual statements of such deposits, as mentioned in the opinion of the Circuit Court of Appeals (R. 395), but communicated and conferred with the president of the Phillip State Bank concerning the bond furnished by that depository for securing bankruptcy deposits (R. 173). The bond was never thereafter increased (R. 113) nor was any order entered changing the status of the depository. Howard filed the required reports (R. 204-206, 264-265, 217, 148, 153, 144, 266).

The loans

The so-called "personal" loans which the Phillip State Bank made to Howard, adverted to in petitioners' brief, pp. 3, 4, 5, 12, 15, 17, 32, were not for Howard's individual use or benefit but for the sole purpose [see opinion below (R. 396) and petitioners' brief, p. 33] of furnishing the working capital for administering the bankruptcy estates of which he was trustee or receiver, capital which was kept in a special revolving account and employed in making petty cash advances to the estates in order to meet and pay estate expenses recurring in the course of administration, such as custodian service fees, mimeographing and stenographic fees, insurance, postage, bookkeeping and inventory service fees, etc. (R. 207, 208, 223, 230, 251-252, 254, 258). Under the practice prevailing in the bankruptcy district and approved by the bankruptcy court, trustees and

receivers regularly provided the funds for the making of such advances and were allowed reimbursement therefor out of the estates upon approval of their reports by the court (R. 254, proof offered). The loans by the Phillip State Bank to Howard were usual bank loans, bearing the regular rate of interest, made upon the personal financial statement of Howard, and approved by the directors and loan committee of the bank (R. 168, 169, 174). The moneys borrowed from the two other banks referred to by petitioners, p. 3, namely, the Foreman Bank and Central Trust Company, were of like character and similarly used to meet estate expenses (R. 229-230, 258, proof offered).

Argument

With respect to the principal question presented, p. 2, *supra*, the opinion below pointed out that in bankruptcy, all discretion with respect to the safekeeping of bankrupt estate funds pending their payment or distribution was removed from the individual trustee or receiver into whose possession the funds came and was lodged instead with the bankruptcy court; that the trustee or receiver could not retain the funds in his own possession as certain public officers might do with regard to official funds nor could he, like the common law fiduciary, place them in any bank which he reasonably should choose, but, rather, was required to deposit them promptly in one of the banks designated as a depository for such funds by the bankruptcy court, and might withdraw them only when directed by the bankruptcy court, and, then, upon a check countersigned by that court; that the bankruptcy court alone investigated and determined which banks should act as depositories, determined what bond or security such depositories should furnish to secure against a loss of funds through a bank failure or other risk, and supervised the

depositories as officers of the court and determined their continuing status (R. 397-398, 399-401). The opinion further pointed out that the individual bond of a trustee or receiver was an official bond and that the undertaking in such bond assuring against loss from any failure of the officer to perform his official duties, referred to the duties stated and defined by law as pertaining to the office and not any act in which the officer might become engaged (R. 398, 399). The Circuit Court of Appeals therefore held that where suit was brought on a trustee's or receiver's bond to recover the amount of funds lost in the closing of a designated depository, on the theory that the trustee or receiver had failed in an official duty to examine, ascertain and judge with ordinary care the financial condition and stability of the bank when depositing the funds there, such action was ill-conceived. The basis of this holding is discussed more fully hereinafter, pp. 12-20.

It is submitted that the case warrants no review by this Court.

The decision below upon the principal question is not in conflict with the decision of any of the other Circuit Courts of Appeal, and no such contention is made. It conflicts with no rule of law stated in any of the applicable decisions of this Court. It is supported by the general weight of authority and reason. See opinion below (R. 401) and pp. 14-16, *infra*. No question is presented calling for the exercise by this Court of its powers over procedure below.

Nor is any issue of public importance raised. The principal issue relates to matters of detail in the deposit of bankrupt estate funds by the trustee or receiver. Petitioners have sought in their brief to lend importance to the case by suggesting that the rule announced below will

place bankrupt estate funds in jeopardy. This suggestion ignores the theory of security underlying depository systems of the kind employed for safekeeping bankrupt estate funds. Protection of such funds pending payment, administration or distribution, is sought not in any individual discretion or control over them by the fiduciary or fiscal officer into whose possession the funds come and in a correlative imposition of liability in the event of his negligent handling thereof, but in the provision for depositories and for the independent and exclusive exercise of the various administrative functions over them with which the authority that is empowered to select and supervise them is charged. It is true that so far as the trustee or receiver in bankruptcy is concerned, the system in resting these functions with the bankruptcy court has removed them from the trustee or receiver. And, equally, the surety on the trustee's or receiver's bond in the individual estates does not guarantee the performance of these functions in what would amount to an underwriting of the solvency of all the designated depositories, a risk assumed by the surety on the bonds of the individual depositories. It does not follow, however, that estate deposits are faced with catastrophe. Greater security is utimately achieved in the placing with an independent authority, investigatorial and supervisory powers over places of deposits for all estate funds in the district.

Petitioners assign, p. 8, three reasons for the granting of the writ. *First*, the Circuit Court of Appeals decided an important question of general law in a way probably untenable or in conflict with the weight of authority. It is submitted that the principal question decided below was one of federal, not general, law, that it was decided correctly and, as above stated, was not of public importance. There is no conflict with the general weight of authority,

and petitioners' assertion to that effect, p. 8, not only is unsupported but is inconsistent with a portion of their later argument, pp. 28-29. The holding which petitioners ascribe to the court in stating their first reason, p. 8, is inaccurate. *Second,* the Circuit Court of Appeals decided an important question of federal law which has not but should be settled by this Court, p. 8. Petitioners, however, do not explain in what way the question, were it important, is unsettled, nor why further pronouncement by this Court is necessary. *Third,* the Circuit Court of Appeals decided a federal question in a way probably in conflict with applicable decisions of this Court. Petitioners, however, make no reference to any such decision and none has been found. The suggestion, p. 8, that the Court of Appeals reached its decision below as a result of confusing the duties of a trustee or receiver in bankruptcy, in respect to estate funds, which petitioners assert to be private funds, and those of a public officer in respect to public funds, misapprehends the basis of the decision. The rule determinative of liability is not concerned with the source or nature of the funds, public or private, but with the presence of a depository system such as that which exists in bankruptcy, pp. 14 *et seq., infra.* Moreover, bankrupt estate funds, to be accurate, are not strictly private funds in the sense in which moneys held by a common law fiduciary or private person are, but are funds subject to administration pursuant to statutory provision.

Considerable of the argument of petitioners contained in the supporting brief reduces itself, upon analysis, to a challenge of the opinion of the Circuit Court of Appeals by differing with that Court upon facts. Petitioners repeatedly emphasize their own factual characterizations. It is believed that these matters are of no general importance and, under the usual rule, alone would afford no

basis for the issuance of the writ. Hence, only the questions of law raised by petitioners' brief, insofar as here deemed relevant, will be examined.

I.

THE DECISION OF THE CIRCUIT COURT OF APPEALS UPON THE PRINCIPAL QUESTION IS IN HARMONY WITH FEDERAL AND STATE DECISIONS INVOLVING THE DUTY OF DEPOSITING OFFICERS IN DEPOSITORY SYSTEMS SIMILAR TO THAT WHICH CONTROLS IN BANKRUPTCY.

In discussing the principal question, petitioners seek to convey the impression, pp. 25-29, that there is a hopeless contrariety of opinion among state and federal authorities as to the responsibility of fiduciaries and public and quasi-public officers for funds, placed in their custody, which are deposited in some bank and thereafter lost in a bank failure. In *Town of Hamden* v. *American Surety Company,* 9 F. Supp. 733 (D. C. Conn.), this apparent confusion was explained as follows, pp. 738-739:

> "Necessarily the liability of such an official will depend on state statutes, if such exist; and in the absence of statute, on the common law of the state which in large measure must be deducted from the administrative system of the state.
>
> Indeed, this underlying principle that the liability of a state official depends upon the local law is the source of much of the confusion on the subject-matter. For the many variations in the administrative systems of the several states necessarily lead to different conclusions as to their respective policies; in some states, as in the federal government, the statutory structure of administration is such as to compel the conclusion that the common law liability of a public custodian has been impliedly modified; in others no such conclusion is justified."

The cases dealing with the liability of fiduciaries, or public or quasi-public officers, for funds placed in their custody and lost in some bank failure, divide themselves into three classes according to the rule of responsibility applied.

In the first class the rule is one of absolute liability. It is limited in application to public officers and holds them strictly liable as insurers for whatever loss may occur. Due care is immaterial. *Mecklenberg County* v. *Beales, Treasurer,* 111 Va. 691, 69 S. E. 1032, 36 L. R. A. (N. S.) 285; *Town of Cameron* v. *Hicks,* 65 W. Va. 484, 64 S. E. 832, 17 Ann. Cas. 926. In none of these decisions, however, is there involved a depository system of the kind existing in bankruptcy.

In the second class the rule of ordinary care and prudence is followed. Here, the common law fiduciary or the public or quasi-public official is held liable only in the event of a failure to exercise ordinary care and prudence as to the safety of the bank when making or maintaining deposits. Common law trustees, *Barney* v. *Saunders,* 57 U. S. (16 How.) 535; *Anguera* v. *Yturria,* 80 F. (2d) 57 (C. C. A. 5); *Carey* v. *Safe Deposit & Trust Co. of Baltimore,* 168 Md. 501, 178 Atl. 242, equity receivers, *Neff* v. *Harmon,* 145 Okla. 114, 291 Pac. 518, assignees for the benefit of creditors, *In re Stone's Assignment,* 220 Ia. 1341, 264 N. W. 604, executors, *In re Kohler's Estate,* 15 Wash. 613, 47 Pac. 30; *In re Workman's Estate,* 196 Ia. 1108, 196 N. W. 35, administrators, *Hart* v. *Savary,* 114 Fla. 41, 152 So. 705; *In re Olson's Estate,* 206 Ia. 706, 219 N. W. 401; *Harper* v. *Betts,* 177 Ark. 977, 8 S. W. (2d) 464, and guardians, *In re Welch's Estate,* 100 Mont. 47, 45 Pac. (2d) 681, are held liable for estate funds lost in a closed bank only if they have failed in such duty. In this class, likewise, are found those cases of public officers in which the courts refuse to apply the strict rule and merely hold them liable

for a failure to exercise due care. *Wilson* v. *People,* 19 Colo. 199, 34 Pac. 944 (involving a clerk of court); *State* v. *Copeland,* 96 Tenn. 296, 34 S. W. 427 (town trustee); *Town of Danbury* v. *Riedmiller,* 208 Ia. 879, 226 N. W. 159 (town treasurer); *State* v. *Gramm,* 7 Wyo. 329, 52 Pac. 533, 40 L. R. A. 690 (state treasurer). As with the first class of cases, none of the above decisions concerns itself with a depository system of the kind here involved.

In the third class, the fiduciary or depositing officer is not held responsible for funds lost on deposit. *Town of Hamden* v. *American Surety Co. of New York,* 9 F. Supp. 733, 738-739, (D. C. Conn.); *City of Scranton, Pa.* v. *Aetna Casualty & Surety Co.,* 11 F. Supp. 986, 988, 989 (D. C. M. D. Pa.); *American Surety Co. of New York* v. *City of Thomasville,* 73 F. (2d) 584, 586, 587 (C. C. A. 5) cert. den. 294 U. S. 721; *Perley* v. *County of Muskegon,* 32 Mich. 132, 135; *Board of Education* v. *Nelson,* 33 N. D. 462, 157 N. W. 664, 665, 666, 667; *Benson* v. *American Surety Co. of N. Y.,* (Minn.) 271 N. W. 125, 126; *Stephens* v. *City of Ludlow,* 159 Ky. 729, 169 S. W. 473, 475; *Magee* v. *Brister,* 109 Miss. 183, 68 So. 77, 78; *Board of Finance* v. *First National Bank,* 71 Ind. App. 290, 124 N. E. 768, 771-772; *Miller* v. *Batson,* 160 Miss. 642, 134 So. 567, 572; *City of New Haven* v. *Fresenius,* 75 Conn. 145, 52 Atl. 823, 825; *Joint School District No. 105* v. *First National Bank,* 125 Okla. 243, 257 Pac. 318, 319. In each of these cases there is involved some depository system set up by statute for the administration and safekeeping of the funds pending disbursement, payment or distribution. While the systems vary in structure—depository systems not only differ among jurisdictions but in the same jurisdiction—all are characterized by what the Circuit Court of Appeals termed in its opinion below a "divided authority" over the funds while in safekeeping (R. 400). The extent of discretion and

control over funds which the officer or fiduciary in the first two classes of cases exercised is not enjoyed by the fiduciary or the depositing officer.

The principle underlying the systems is essentially that of checks and balances and involves the following features: (a) the fiduciary or officer who receives the funds and who generally is vested with all or some amount of the disbursing power may not retain the funds in his own possession during the period of safekeeping or exercise any general discretion as to the place where they are to be kept, (b) he is required to deposit the funds in a depository designated for that purpose and can make no deposits, or place the funds, elsewhere, (c) the power to select, designate and supervise such depository, to revoke its designation and designate new depositories, is lodged with a person or body other than the fiduciary or officer. The requirement that such fiduciary or officer promptly deposit the funds in a depository chosen for such purpose by the designating authority and the consequent shifting away from him of the power or discretion to select and designate the depository, form the basis upon which the courts hold that the legislative intent was to impose no liability upon the fiduciary or officer in the event of a loss through the closing of the depository. The decisions point out that where the stated features appear and his discretion is thus limited, the fiduciary or officer was not intended to be an insurer of the funds, and what an ordinary prudent person might have done with his own moneys in depositing them in the depository is wholly irrelevant. On the other hand, where some of the features are not present, as where the depositing officer is required by statute to deposit the funds in a bank but has authority to designate what bank shall act as depository, it is held that the legislative intent was not to relieve him from responsibility for loss. *State* v. *Bob-*

leter, 83 Minn. 479, 86 N. W. 461. In some jurisdictions the rule has found its way into an express statutory provision of exoneration. *State* v. *Bowers,* 26 Oh. Cir. Ct. 326, aff'd. 70 Oh. St. 423, 72 N. E. 1155. However, express statutory exoneration is unnecessary. See particularly *City of Scranton, Pa.* v. *Aetna Casualty & Surety Co., supra,* 11 F. Supp. 986, 988 (D. C. M. D. Pa.).

As a corollary to the rule of these cases, it is held that where a bond is required by law of the designated depository to secure deposits, the fiduciary or depositing officer is under no duty to inquire into the amount or sufficiency of such bond if the amount is fixed and terms approved by some one other than the fiduciary or depositing officer. *Town of Lakeland* v. *Ballmer,* 209 Wis. 636, 245 N. W. 682, 683; *Board of Education* v. *Nelson,* 33 N. D. 462, 157 N. W. 664, 667; see *City of Missoula* v. *Dick,* 76 Mont. 502, 248 Pac. 193, 195; *Illinois Surety Co.* v. *United States,* 226 Fed. 665, 667 (C. C. A. 7).

The depository system established under the bankruptcy act and general orders in bankruptcy for the safekeeping of bankrupt estate funds during administration is similar in its essential features to the federal depository system provided by the acts of Congress [see *Town of Hamden* v. *American Surety Co.,* 9 F. Supp. 733, 738 (D. C. Conn.)], and the systems involved in the above cases:

The trustee or receiver in bankruptcy and his duties with respect to estate funds coming into his possession for safekeeping. While the provisions of the Act and general orders relating to the safekeeping of bankrupt estate funds do not expressly apply to receivers, it is well settled that the duties of receivers in this respect are the same as those of trustees. *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.,* 54 F. (2d) 329, 335 (C. C. A. 8).

Trustees and receivers are depositing officers. They are required to "deposit all money received by them in one of the designated depositories." Bankruptcy Act, sec. 47 (a), (3), 11 U. S. C. A. 75 (a) (3). This duty is mandatory. *In re Potell,* 53 F. (2d) 877, 879, (D. C. N. Y.); *In re Hoyt,* 119 Fed. 987, 988 (D. C. N. C.); *In re Kyle,* 181 Fed. 617, 621 (C. C. D. Mass.); *Huttig Mfg. Co.* v. *Edwards,* 160 Fed. 619, 622-623 (C. C. A. 8); *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.,* 54 F. (2d) 329, 335 (C. C. A. 8). Thus, depositing estate funds in a bank will not save the deposit from being unlawful if the bank is not a designated depository. *In re Potell,* 53 F. (2d) 877 (D. C. N. Y.); *In re Hoyt,* 119 Fed. 987 (D. C. N. C.). Nor will an order by the district court in bankruptcy specifically directing that the deposit be made in a non-designated bank render the deposit any the less illegal. *Huttig Mfg. Co.* v. *Edwards,* 160 Fed. 619, 622 (C. C. A. 8); *R. J. Reynolds Tobacco Co.* v. *A. B. Jones Co.,* 54 F. (2d) 329 (C. C. A. 8). Similarly, a disbursement by the trustee or receiver out of funds in his possession, without first depositing the funds in a designated depository and then making the disbursement, is improper. *In re Hoyt & Mitchell,* 127 Fed. 968 (D. C. N. C.); *In re Kyle,* 181 Fed. 617 (C. C. D. Mass.). On the other hand, there is no need for the trustee or receiver, before depositing in a designated depository, to secure an order directing the same. *In re Singer Furniture Corp.,* 47 F. (2d) 780, 783 (D. C. S. D. N. Y.).

The trustee or receiver is obliged to determine whether the particular banking institution in which he proposes to make deposits is a designated depository. This he can do by examining the formal order of designation required by statute. Bankruptcy Act, sec. 61, 11 U. S. C. A. 101. Where the order of designation places some restriction upon the making of deposits, as a limitation upon deposits

in excess of a stated amount, the trustee or receiver is required to observe such restriction. However, if the order is a general order, the trustee or receiver is free to make deposits without particular restraint. *Illinois Surety Co.* v. *United States,* 226 Fed. 665, 667 (C. C. A. 7); see also cases cited p. 16, *supra.*

Trustees, and consequently receivers, as depositing officers, are required within the first month after appointment to file and make every two months thereafter, reports with the district court in bankruptcy showing the amount of bankrupt estate funds on hand and what other information the court shall require. Bankruptcy Act, sec. 47 (a) (10), 11 U. S. C. A. 75 (a) (10).

Trustees and receivers are not merely depositing officers; they also make disbursements. However, their power to disburse is limited by statute and general order. Section 47 of the Act provides that disbursements may be made "only by check or draft" on the depository. 11 U. S. C. A. 75 (a) (4). General Order 29 provides that "No moneys deposited as required by the act shall be drawn from the depository unless by check or warrant, countersigned by the judge of the court, or by a referee designated for that purpose, or by the clerk (of the court) or his assistant under an order made by the judge * * *." 11 U. S. C. A. 53. These requirements are likewise mandatory. *Huttig Mfg. Co.* v. *Edwards,* 160 Fed. 619, 622-623 (C. C. A. 8); *In re Hoyt,* 119 Fed. 987, 988 (D. C. N. C.). In some districts it is held that these provisions prevent the making of deposits in the name of the trustee or receiver as such officer, but require the deposits to be made in the name of the bankruptcy court. *In re Cobb,* 112 Fed. 655.

The bankruptcy court as the designating and administrative authority. The district court in bankruptcy has abso-

lute authority over the designation and supervision of depositories for bankrupt estate funds. Bankruptcy Act, sec. 61, 11 U. S. C. A. 101. Exclusive discretion and power are given it to select among banking institutions and designate those which are to act as depositories. No restriction is placed by the Act upon the terms which may be required as a condition to designation except that a depository bond payable to the United States shall be furnished. *Ibid.* The amount of the bond is left to the approval of the court, and it may from time to time increase the amount thereof. *Ibid.* The court has full power to change the depository and appoint new ones as the occasion may require. *Ibid.*

The court in designating and supervising depositories acts principally in an administrative rather than judicial capacity. See discussion *Board of Finance* v. *First National Bank*, 71 Ind. App. 290, 124 N. E. 768. It employs summary orders, *In re Howard*, 130 Fed. 1004 (D. C. Cal.); *In re Ocean City Title & Trust Co.'s Bond*, 6 F. Supp. 311 (D. C. N. J.); *In re Potell*, 53 F. (2d) 877 (D. C. N. Y.); requires reports from trustees, receivers and depositories, 11 U. S. C. A. 75 (a) (10), countersigns all checks drawn on depositories, 11 U. S. C. A. 53, Gen. Ord. 29; and follows a characteristically non-judicial procedure (see R. 148, 173).

The designated depository and funds in its possession. The position of the designated depository in the system sufficiently appears from what has above been stated. So far as receiving bankrupt estate funds, its conduct is controlled by the order of designation, other orders made by the bankruptcy court, and general law. It is amenable to summary order. Designated depositories are themselves officers of the court. *State of Kansas* v. *U. S, Fid. & Guar. Co.*, 81 Kan. 660, 106 Pac. 1040, 26 L. R. A. (N. S.) 865; *State* v. *U. S. Fid. & Guar. Co.*, 210 Wis. 178, 246 N. W.

434; *Miller* v. *Batson,* 160 Miss. 642, 134 So. 567; *Perkins* v. *State,* 130 Miss. 512, 94 So. 460; *Board of County Com'rs.* v. *Mason,* 38 Wyo. 1, 264 Pac. 93. Funds deposited with the depository are withdrawn from *custodia legis* and become simple debt claims against the bank. *Gardner* v. *Chicago Title & Trust Co.,* 261 U. S. 453. The depository is responsible for any loss which may arise if it permits a receiver or trustee to withdraw bankrupt estate funds by a check that is not countersigned by the bankruptcy court. *In re Singer Furniture Corp.,* 47 F. (2d) 780 (D. C. N. Y.).

As the Circuit Court of Appeals pointed out, the depository system in bankruptcy is the same type as the federal and state systems involved in the cases above where the rule of non-responsibility was applied to the depositing officer. The removal from the trustee or receiver in bankruptcy, within the ambit of his office, of any discretion with respect to the safekeeping of estate funds in a designated depository, places him in a role different from that of the public officer who could, if he wished, put official funds in his own pocket and was held to an insurer's liability in the event they were lost in a bank failure, or the common law fiduciary making deposits in such bank as he chose and withdrawing them at will, who was held liable for a similar loss if he failed to observe ordinary care and prudence for their safety.

The decision of the Circuit Court of Appeals upon the principal question is correct, in harmony with authority and presents no case warranting review within the meaning of the rules. The opinion itself affords a careful, well-considered precedent.

II.

PETITIONERS' BRIEF, PP. 15-18 CONSIDERED.

The excerpt from the opinion quoted in petitioners' brief, p. 15, is not, as petitioners assert, a *summation* of the Circuit Court of Appeals' decision, nor is the "implication" which petitioners proceed to find in the words, nor the suppositious applications which they make thereof, indicative fairly of the holding. The Court did not treat of "apparent dangers" to funds, of "bad management" or "failing condition" of depositories, or of trustees causing depositories "to bid for such funds by the promise of fees," or "for corrupt motives." The Court determined that in an action on the official bond of the trustee or receiver no recovery could be had for bankruptcy deposits lost in a designated depository which closed, on the theory that in bankruptcy a trustee or receiver is under an official duty when making deposits of estate funds in a depository, to investigate, ascertain and judge the stability of the bank and the possibility of its closing.

Petitioners apparently contend, p. 16, that the trustee or receiver, though under a mandatory obligation to place estate funds in one of the designated depositories, nevertheless has a duty to evaluate the position of the various depositories in the district and to select among them, that he must consider such matters as the relation between the size of the depository bond of each of the various depositories and the total amount of bankruptcy deposits in all the various estates which he individually administers. And, presumably, he must ascertain and consider when making deposits, the amount of estate funds deposited and main-

tained on deposit in each of the depositories from time to time by all of the other receivers and trustees in the district. Petitioners point, p. 16, to twenty-one different banks qualified as depositories when the first deposits were made in 1930, and say that "at all times thereafter * * * there was a substantial number of such depositories."

Under the depository system in bankruptcy all depositories are in law upon an equal footing. Each is designated by the bankruptcy court and continues under its supervision; each is an officer of the court and subject to summary order. In the nature of the system no duty exists for the trustee or receiver to exercise an individual discretion as to the relative security of the depositories and, in effect, to review the judgment of the designating authority at the risk of being held liable for negligence. In the case at bar, the bankruptcy court, supervising the depositories, entered an order in June, 1931, requiring receivers to file complete reports showing the amount of estate deposits kept in the depositories and the names of the depositories (R. 145). Reports of this character were filed by Howard as trustee and receiver with the court, quarter-annually, throughout the period (R. 204-206, 264-265, 217, 148, 153). Evidence was offered of the compilation then made by that court of the aggregate sum of the estate deposits of all receivers and trustees in each depository (R. 156-158). With respect to the Phillip State Bank the bankruptcy court made particular inquiry of the depository in the middle of 1931 (R. 173). Additional or increased depository bonds were required of some of the depositories but not of the Phillip State Bank (R. 112-113).

It might be noted that of the twenty-one depositories mentioned by petitioners, five-sevenths either failed or had

been or were compelled to merge.* The period involved occurred in the midst of a general bank panic and crisis. What the relative safety was, if any, of the various depositories is not shown by the record. There is no evidence of their respective financial positions, their liquidity, the amount of estate funds on hand from time to time deposited by the various trustees and receivers, the relation to such amount of the amount of the depository bonds, etc. (R. 109, 277). Indeed, evidence of this character offered by respondents was refused (R. 277-283, 156-158).

Petitioners' contention, pp. 17-18, appears to be that because of the so-called "personal" loans made to Howard by the Phillip State Bank, Howard "prejudiced his judgment" as to that particular depository and that such matter is an element to be considered in determining whether he acted as an ordinary prudent person. This argument begs the question. It assumes the existence of a duty.

Depositories which failed: South Side Trust & Savings Bank, Washington Park National Bank (R. 138, 113), Peoples Trust & Savings Bank, South Side Bank & Trust Company, Transportation Bank of Chicago, Chicago Bank of Commerce, Cosmopolitan State Bank, Edgewater Trust & Savings Bank, Jackson Park National Bank, Woodlawn Trust & Savings Bank. As to the latter banks, see official report of Illinois State Auditor, *Statements Showing Total Resources and Liabilities of Illinois State Banks,—at the close of business June 29, 1935*, pp. 26, 28, 31, 32, of which judicial notice may be taken. *McCrary* v. *Schenebeck*, 191 Ark. 698, 87 S. W. (2d) 572, 574.

Depositories which merged: Foreman State National Bank, National Bank of the Republic, both of which were "loop" banks, Chicago Trust Company (R. 138, 201, 112-113), State Bank of Chicago and Union Trust Company (R. 112, 113; said report, p. 28).

Much is said generally by petitioners about the loans as a basis for challenging the opinion of the Circuit Court of Appeals. It will be observed that except for a brief statement at the very close of petitioners' brief, p. 33, all mention of the nature of the loans is avoided. The character of these loans has been stated, above, pp. 7-8. While they were personal in the sense that Howard individually bound himself for their repayment, they were not personal in the sense that they were made for his individual gain or advantage. The money was borrowed and used solely for the benefit of the estates which he administered and in the interest of their efficient and thrifty management. The funds were advanced to the estates and used to meet recurring petty administrative expenses in order to avoid continuous petitioning of the bankruptcy court for allowances to meet such items. This was the general practice among receivers and trustees and had the full approval of the bankruptcy court (R. 254, evidence offered).

Petitioners argue, p. 33, that Howard was under no duty to make such advances. A similar contention made in a case where common law trustees had borrowed moneys for the benefit of their estates, was dismissed by the court with the words "It is no answer to say that they could have applied to the court to borrow such funds each time the necessity arose to do so in order to carry on operations." *Purdy* v. *Bank of America Nat. Trust & Savings Ass'n.*, 2 Cal. (2d) 298, 40 Pac. (2d) 481, 482.

III.

PETITIONERS' BRIEF, PP. 18-21 CONSIDERED.

Petitioners' contentions, pp. 18-21, are not clear. The statement, p. 18, that the opinion below intimated that Howard might be personally liable, is not correct. The

Court said that the matter was one which it was "not called upon to decide" (R. 402). The assertion, p. 19, that bankrupt estate funds are private funds errs as a matter of law. Pending their deposit in a designated depository the funds are in *custodia legis*, and upon deposit they become claims against the depository subject to administration under the bankruptcy act and withdrawal upon court direction (see opinion, R. 401). The quotation, p. 19, from Ruling Case Law is the general rule that the undertaking of a surety of an official bond is co-extensive with the officer's official duties.

The cases cited by petitioners, p. 20, do not stand for the propositions stated. In each of the cases there was involved an express statutory limitation upon the amount of deposits which could be placed in the bank, and the deposits exceeded the limitation. The rule in bankruptcy, as well as the general rule, is that in the absence of an express restriction the depositing officer need not concern himself with the amount or sufficiency of the security given by the depository (see pp. 17-18, 16, *supra*).

IV.

PETITIONERS' BRIEF, PP. 21-25 CONSIDERED.

a. Howard obeyed all orders of the court.

There is no evidence whatsoever of a breach of the proviso of the bonds to secure performance by Howard of orders of the bankruptcy court. As the Circuit Court of Appeals said, "there is no evidence of a breach of condition (1). There is no proof of violation of any order of the District Court nor of any loss to an estate arising from disobedience of any court order" (R. 396). The dissenting opinion expressly states that the issue of the

case falls under the proviso dealing with "official duties" (R. 402). Petitioners' statement, p. 22, "the jury was entirely justified in believing that Howard had not made any such report" as required by the June 11, 1931 order, ignores the fact that the trial court below never submitted to the jury any issue upon a failure to report (R. 295, *et seq.*) and in effect directed a verdict contrary to petitioners' contention. Howard filed with the bankruptcy court the required reports showing both the amount and place of the deposits in the Phillip State Bank, as of June, September and December, 1931 and March, 1932 (see p. 22, *supra*). The usual trustee's and receiver's periodic reports and accounts of funds were made by Howard in each of the estates, and in fact it was so conceded (R. 144, 266).

b. Howard accounted for the estate funds.

The Circuit Court of Appeals construed the language of the proviso of the bonds assuring that Howard would account, as follows: "This language imposes upon the trustee the duty to make honest and correct reports or accountings of estate funds as required by law, and to dispose of the funds so reported or accounted for in accordance with the law" (R. 397). As above stated and as the Court below said, "there is no proof that Howard failed to make or render reports or accounts according to law" (R. 397). With respect to the disposition of the funds in accordance with law, the Court pointed out that the cause involves no charge such as defalcation, embezzlement or other improper distribution of funds and that the sole question which might arise under this proviso would relate to whether an official duty existed in a trustee or receiver to judge, with care, the stability of a designated depository in which estate funds were deposited (R. 397).

This question has already been considered above and requires no further discussion.

The suggestion, p. 23, that the loss to the estates might have occurred because of a delay in distribution to creditors, apparently finds its source in a similar suggestion contained in the dissenting opinion (R. 403). There is nothing in the record concerning any delay in the regular administration and progress of any of the estates involved, let alone in which one of the estates such alleged delay occurred. The complaint did not so aver (R. 2, *et seq.*); no evidence thereof was ever offered; the trial court did not so charge (R. 294, *et seq.*); and petitioners never so contended, whether in the District Court or in the Circuit Court of Appeals.

c. Howard performed his official duties.

Petitioners' contentions, pp. 23-25, have in the main been considered in the discussion above upon the principal question presented, pp. 12-20, *supra*. Part of petitioners' argument, p. 23, refers confusedly to depository bonds, that is, bonds given by the depository itself and whose coverage of course assures against loss through insolvency or bank failure. The case at bar, however, is concerned with the personal bond of the trustee or receiver given in each individual estate to secure performance of the official duties of the trustee or receiver. The cases cited by petitioners, pp. 23-25, do not decide the question presented. *United States* v. *Perkins*, 280 Fed. 546 (C. C. A. 8) held that a sale by a trustee of estate property with the wrongful intent and purpose of paying a prior lien claimant whose claim had already been paid in order to defeat a subsequent lien-holder, was a breach of a trustee's bond. *In re Hoyt, et al.*, 119 Fed. 987 (D. C. N. C.) held that a trustee could not properly make disbursements of bank-

rupt estate funds without first depositing them and then making the disbursements upon order and counter-signed check. *Jordon* v. *Baker,* 252 Ky. 40, 66 S. W. (2d) 84, held that mandamus would lie to compel the issuance of a quietus to a fiscal officer who had deposited county funds in a designated depository which failed, and that decisions applying the insurers' rule would not be followed. By way of *dictum,* it was suggested that knowledge in the officer warranting him taking action with respect to deposits might amount to "that degree of negligence" imposing a bailee's liability. Three months after the *Jordan* case was decided, the Kentucky legislature enacted into legislation the general rule of non-responsibility which the court in the earlier case of *Stephens* v. *City of Ludlow,* 159 Ky. 729, 169 S. W. 473, had announced. Ky. Acts 1934, c. 22. See p. 14, *supra. Edwards* v. *Logan County,* 244 Ky. 296, 50 S. W. (2d) 83, was concerned with a judgment below based upon the insurer's liability rule. The case was reversed for new trial, the court pointing out that when the bank was designated a depository and the officer was directed to deposit the funds there and he obeyed, the designating authority "assumed responsibility for the integrity and solvency of the institution and exonerated him from loss of funds if suffered solely on that account." *Ibid.* 50 S. W. (2d) p. 86. *State* v. *McNamer,* 62 Mont. 490, 205 Pac. 951, held that where the county collector was under duty to pay over city funds to the city treasurer as promptly as they were computed but failed to do so, and instead permitted them to remain on deposit in a designated depository, liability for such failure might be imposed. Other cases and arguments of petitioners cited pp. 24-25, require no comment.

The statement, p. 25, that "the violation of duties, above set forth, were all admitted with the exception of the fail-

ure to make reports of total deposits'' is untrue. Respondents have maintained throughout that even if the duty assumed by petitioners existed, no violation in fact occurred. Considerable argument was had in the Circuit Court of Appeals on this question but was not considered by the Court because the supposed duty, as a matter of law, did not exist (Opinion, R. 398, 402).

V.

PETITIONERS' BRIEF, PP. 25-30 CONSIDERED.

The contention of petitioners' brief, pp. 25-30, has been considered in what has been said above.

VI.

PETITIONERS' BRIEF, PP. 30-32, CONSIDERED.

It is self-evident that no constitutional issue is here presented. Indeed, the constitutional question which petitioners urge, p. 31, is raised for the first time in their petition for certiorari. The proposition that petitioners are being deprived under the decision below of their right to recover for negligence, and hence of their constitutional guarantee, errs among many reasons in its assumption of the supposed official duty. The cases in the note in 38 A. L. R. 1512, to which petitioners refer, are inapplicable. *cf. Schenebeck* v. *McCrary*, 298 U. S. 36.

Conclusion

Respondents presented in the Circuit Court of Appeals several additional grounds for a reversal of the judgment of the District Court (R. 313, *et seq.*). Error was assigned as to the admission and exclusion of certain evidence (R. 313-324), to the giving of certain instructions to the jury (R. 329-346), etc. The Circuit Court of Appeals in granting a new trial, stated that "the discussion of other features is unnecessary" (R. 402). The assignment of these errors below, to which reference is respectfully made, sets out separately and particularly each of the errors and the specific ground for review. Petitioners have not discussed these other questions and respondents, reserving all rights, have likewise not done so.

It is respectfully submitted that the cause warrants no review by this Court and, therefore, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX.

Section 47 of the Bankruptcy Act, 11 U. S. C. A. 75:

"(a) Trustees shall respectively * * * (3) deposit all money received by them in one of the designated depositories; (4) disburse money only by check or draft on the depositories in which it has been deposited * * *."

General Order XXIX, 11 U. S. C. A. 53:

"No moneys deposited as required by the Act shall be drawn from the depository unless by check or warrant, signed by the clerk of the court, or by a trustee, and countersigned by a judge of the court, or by a refereee designated for that purpose, or by the clerk or his assistant under an order made by the judge, stating the date, the sum, and the account for which it is drawn * * *."

Section 61 of the Bankruptcy Act, 11 U. S. C. A. 101:

"Courts of bankruptcy shall designate, by order, banking institutions as depositories for the money of bankrupt estates, as convenient as may be to the residences of trustees, and shall require bonds to the United States, subject to their approval, to be given by such banking institutions, and may from time to time as occasion may require, by like order increase the number of depositories or the amount of any bond or change such depositories."